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SUBJECT: WILL THE OIL MINISTRY LICENSING ROUND PROCESS
IMplode?

REF: A. BAGHDAD 148

[1](#)B. BAGHDAD 84

[1](#)C. BAGHDAD 45

[1](#)D. 08 BAGHDAD 3397

Classified By: Economic Counselor Michael Dodman, reasons 1.4(b,d)

[1](#)1. (S) Summary: The Iraqi Ministry of Oil has announced the next step in the licensing round process to invite international oil company (IOCs) participation in Iraq's petroleum sector -- a February 12-14 workshop in Istanbul for the 16 companies (out of 41 pre-qualified) who had paid the required fees. Several international oil companies complained that the model contract offered to IOCs had overly restrictive terms and conditions; they hope to be able to press for changes that reflect drastically lower crude oil prices and the scale of the investments required to meet the contractual obligations. At the same time, the Iraqi Oil Ministry seems to be grasping the implications of the lower crude prices, with Oil Minister Shahristani reportedly floating the possibility of cancelling the licensing round with his staff (ref A). Notwithstanding, the Oil Ministry launched a second licensing round December 31. The Oil Ministry's best approach would be to continue the licensing round process by seriously taking on board IOC input at the workshop to modify the model contract and the arrangements for IOC entry into Iraq's petroleum sector. End summary.

Forward Movement

[1](#)2. (U) Spokesman Assem Jihad announced January 18 that the Ministry of Oil (MoO) would hold a workshop in Istanbul to receive suggestions and input from international oil companies (IOCs) regarding the model contract and bidding procedures for the licensing round that Oil Minister Shahristani presented at an October 13 workshop (ref D). (Note: The licensing round invited tenders on six producing oil fields and two gas fields that are not currently producing.) While Jihad did not specify the date, a wire service story, citing an unnamed Iraqi oil official, said the workshop would occur February 12-14. The same source said only 16 companies, out of the 41 which had been pre-qualified to participate, had paid participation fees and purchased the draft model contract, initial tender protocols, and data packages. The 16 companies, however, included most of the oil majors. (Note: Oil Minister Shahristani, however, said over 30 companies had purchased data packages during a January 4 meeting with EMIN. End note.)

[1](#)3. (U) In another development, MoO announced December 31 that it would launch a second bid round for 11 additional oil and gas fields. During a news conference, Shahristani said the fields comprised Majnoon, West Qurna Phase II, Halfaya, East Baghdad, Gharaf, Qayiarah, Najmah, Badrah, Kifil/West

Kifil/Merjan, a group of fields in Diyala Province (composed of Qumar, Gilabat and Nau Domman oil fields along with Khashim al-Ahmar gas field), and Siba gas field in Basrah Province. Three of the fields are cross-border, extending into the territories of Iran or Kuwait. Shahristani said the 11 fields could increase production by up to 2.5 million barrels per day (bbl/d), or potentially doubling Iraq's production, within three to four years of the contracts being signed by the end of 2009.

Shell Unenthusiastic

¶ 14. (SBU) During a January 12 meeting with MNF-I's Energy Fusion Cell (EFC), Shell Exploration and Production executives described the licensing round contracts as "extremely challenging," since the contractor would incur financial penalties to maintain and increase production with limited influence and control over the entire process.

(Comment: One area that has been previously highlighted is the inability independently to verify current production and MoO's assumption that current production is stable, rather than declining. Since some profits will be calculated from the barrels of oil increase from a baseline, an artificially low baseline production would cut into the profit.) The Shell executives also noted that profit margins were very low. For example, with the Kirkuk field, the contractor would need to maintain current production of about 350,000 bbl/d. Profit would be calculated on the basis of the number of barrels above the baseline. Shell calculated that \$4 billion or more would be needed to increase production from the Kirkuk field.

¶ 15. (SBU) Despite these challenges, Shell intended to participate in the licensing round, since their competitors were sure to do so and Shell needed to keep its foot in the door. The Shell executives noted that Shell has been working in the Kirkuk field for the past three years, and also in the Maysan fields. In 2005, the company had started negotiating a technical service contract for Kirkuk and Maysan that was subsequently cancelled. (Comment: Given this record, Shell could be expected to bid on Kirkuk and/or Maysan in the licensing round.) Shell also noted that, since the bids would be assessed on the basis of the lowest cost to the GOI, companies could deliberately submit an unrealistically low bid.

Other Negative Indicators

¶ 16. (U) A third company, Cairn Energy PLC, in a conversation with MNF-I, made the same points, i.e., that the terms were too stringent but that oil companies would participate and then try to modify contract terms during the workshop and in follow-on negotiations.

¶ 17. (SBU) We had commented previously that a bellwether of IOC interest in the licensing round would be whether they participated in the December 5-7 "Energy Expo" held at the Baghdad International Airport (BIAP) convention center. In the event, ConocoPhillips, Repsol, Maersk, and Woodside (of the 41 pre-qualified companies and all of them mid-sized companies) participated, but not any of the oil "majors."

Problematic Contracts

¶ 18. (U) Although the model contract is supposed to be business confidential and available only on payment of a fee, at least one internet analysis of the model contract is available. According to the analysis, the model contract, dated November 13, employs strict procedures and a cumbersome structure to ensure that Iraq maintains sovereignty and control of the producing oil fields while allowing entry of foreign partners. The contracts provide for a "field operating division" to be established within the existing regional oil companies -- North Oil Company, South Oil Company, and Maysan

Oil Company -- that would "exclusively serve as operator of the field" on behalf of the contractual parties. At the same time, the foreign company or consortium and the Iraqi regional oil company would form a joint venture "contractor," which would appoint one company to act as "co-operator" of the field to coordinate field operations. The co-operator will take a "substantial role" in planning, decision-making, and day-to-day operations by the Iraqi operator. In addition, a "joint management committee" will oversee the entire structure.

¶9. (U) The internet analysis cites an expert who suggests that "if the foreign company is not in charge, it cannot be held responsible." The analysis notes that the foreign partner, while holding a minority stake of 49%, would implicitly be responsible for providing all necessary capital, technology and services, and incurring all costs to achieve targets for incremental, enhanced, and plateau production. According to the draft, the establishment of the field operating division "shall in no way relieve the contractor of its obligations to achieve the production targets under the contract." The model contract for the green-field natural gas fields, while still using an overly complicated structure, is not as onerous.

GOI Perhaps Reviewing Its Approach

¶10. (S) As reported ref A, Oil Minister Shahristani surprised his staff by inquiring what the fall-out would be of cancellation of the licensing round. MoO officials urged him not to take such a step, emphasizing the negative consequences. The media report announcing the workshop also quoted an unnamed MoO source as saying the workshop would provide the opportunity for the Ministry to "listen to proposals, comments and suggestion from oil companies" and reported that the goal was "to narrow the gap between the Oil Ministry and companies." (Comment: This contradicts Shahristani's earlier suggestion to us during an October meeting, immediately after the licensing round was launched, that the model contract would not be substantially modified as a result of the workshop.)

Comment

¶11. (C) The launch of Deputy Prime Minister Barham Salih's initiative to review existing MoO procedures and policies (ref B) and develop recommendations to boost oil production has further complicated the picture and will likely increase pressure on Shahristani to make the bid round successful. The best outcome of the February workshop would be a simplified bidding procedure which allows the IOC to act as a real operator of the field in true partnership with the MoO regional oil company. Chevron Vice President Jay Pryor will be in Baghdad January 25, and will have the opportunity to urge this approach in a meeting with Shahristani. The stakes are high. Failure or suspension of the licensing rounds would further delay the substantial investments required to rehabilitate Iraq's oil fields, stop production declines, and boost production to levels commensurate with Iraq's oil resources.

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